

(ii) The application of section 801(g)(4) and subdivision (i) of this subparagraph may be illustrated by the following example:

*Example.* Company M, a life insurance company issuing only variable annuity contracts of the type described in section 801(g)(1) and paragraph (a)(1) of this section, increased its life insurance reserves held with respect to such contracts during the taxable year 1959 by \$275,000. Of the total increase in the reserves, \$100,000 was attributable to premium receipts, \$50,000 to dividends and interest, \$100,000 to unrealized appreciation in the value of the assets held in relation to such reserves, and \$25,000 to realized capital gains on the sale of such assets. As of the close of the taxable year 1959, the reserves held by company M with respect to all variable annuity contracts amounted to \$1,275,000. However, under section 801(g)(4) and subdivision (i) of this subparagraph, this amount must be reduced by the \$100,000 unrealized asset value appreciation and the \$25,000 of realized capital gains. Accordingly, for purposes of section 810 (a) and (b), the amount of these reserves which is to be taken into account as of the close of the taxable year 1959 under section 810(c) is \$1,150,000 (\$1,275,000 less \$125,000).

(c) *Companies issuing variable annuities and other contracts.* (1) In the case of a life insurance company which issues both annuity contracts described in section 801(g)(1) and paragraph (a)(1) of this section and other contracts, the policy and other contract liability requirements (as defined in section 805(a) and paragraph (b) of § 1.805-4) of such a company for any taxable year shall be considered to be the sum of:

(i) The policy and other contract liability requirements computed with respect to the items which relate to such variable annuity contracts, and

(ii) The policy and other contract liability requirements computed by excluding the items taken into account under subdivision (i) of this subparagraph.

(2) [Reserved for regulations to be issued under section 801(g)(5)(B).]

(d) *Termination.* Paragraphs (1), (2), (3), (4), and (5) of section 801(g) and paragraphs (a), (b), (c), and (d) of this section shall not apply with respect to any taxable year beginning after December 31, 1962.

[T.D. 6610, 27 FR 8717, Aug. 31, 1962]

### § 1.801-8 Contracts with reserves based on segregated asset accounts.

(a) *Definitions.*—(1) *Annuity contracts include variable annuity contracts.* Section 801(g)(1)(A) provides that for purposes of part I, subchapter L, chapter 1 of the Code, an annuity contract includes a contract which provides for the payment of a variable annuity computed on the basis of recognized mortality tables and the investment experience of the company issuing such a contract. A variable annuity differs from the ordinary or fixed dollar annuity in that the annuity benefits payable under a variable annuity contract vary with the insurance company's investment experience with respect to such contracts while the annuity benefits paid under a fixed dollar annuity contract are guaranteed irrespective of the company's actual investment earnings.

(2) *Contracts with reserves based on a segregated asset account.* (i) For purposes of part I, section 801(g)(1)(B) defines the term *contract with reserves based on a segregated asset account* as a contract (individual or group):

(a) Which provides for the allocation of all or part of the amounts received under the contract to an account which, pursuant to State law or regulation, is segregated from the general asset accounts of the company,

(b) Which provides for the payment of annuities, and

(c) Under which the amounts paid in, or the amount paid as annuities, reflect the investment return and the market value of the segregated asset account.

(ii) The term *contract with reserves based on a segregated asset account* includes a contract such as a variable annuity contract, which reflects the investment return and the market value of the segregated asset account, even though such contract provides for the payment of an annuity computed on the basis of recognized mortality tables, but the term includes such contract only for the period during which it satisfies the requirements of section 801(g)(1)(B) and subdivision (i) of this subparagraph. However, such term does not include a pension contract written on the basis of the so-called new-money concept. Thus, for example, such term

does not include a pension contract whereby reserves are credited on the basis of the company's new high yield investments. Furthermore, such term does not include a contract which during the taxable year contains a right to participate in the divisible surplus of the company where such right merely reflects the company's investment return. Nevertheless, the term does include a contract which meets the requirements of section 801(g)(1)(B) and of this subparagraph even if part of the amounts received are, for example, allocated to reserves under provisions of the contract which are written on the basis of the new-money concept. However, such reserves do not qualify as a segregated asset account referred to in section 801(g) and this section.

(iii) If at any time during the taxable year a contract otherwise satisfying the requirements of section 801(g)(1)(B) and subdivision (i) of this subparagraph ceases to reflect current investment return and current market value, such contract shall not be considered as meeting the requirements of section 801(g)(1)(B)(iii) and subdivision (i) (c) of this subparagraph after such cessation. Thus, a contract with reserves based on a segregated asset account includes a contract under which the reflection of investment return and market value terminates at the beginning of the annuity payments, but only for the period prior to such termination. For example, if the purchaser of a variable annuity contract which meets such requirements elects an option which provides for the payment of a fixed dollar annuity, then such contract shall be considered as satisfying such requirements only for the period prior to the time such contract ceases to reflect current investment return and current market value. Furthermore, a group annuity contract which satisfies the requirements of section 801(g)(1)(B) and subdivision (i) of this subparagraph shall be considered as continuing to meet such requirements even though a certificate holder under the group contract elects an option which provides for the payment of a fixed dollar annuity. However, the annuity attributable to such certificate holder shall not be considered as satisfying such require-

ments as of the time such annuity ceases to reflect current investment return and current market value. On the other hand, a group annuity contract which does not reflect current market value shall not be considered as satisfying such requirements even though a certificate holder under the group contract elects an option which provides for the payment of a variable annuity. However, the variable annuity attributable to such certificate holder shall be considered as satisfying such requirements as of the time such variable annuity commences to reflect current investment return and current market value.

(b) *Life insurance reserves.* Section 801(g)(2) provides that for purposes of section 801(b)(1)(A), the reflection of the investment return and the market value of the segregated asset account shall be considered an assumed rate of interest. Thus, the reserves held with respect to contracts described in section 801(g)(1) and paragraph (a) of this section shall qualify as life insurance reserves within the meaning of section 801(b)(1) and paragraph (a) of § 1.801-4 provided such reserves are required by law (as defined in paragraph (b) of § 1.801-5) and are set aside to mature or liquidate, either by payment or reinsurance, future unaccrued claims arising from such contracts with reserves based on segregated asset accounts involving, at the time with respect to which the reserve is computed, life, health, or accident contingencies. Accordingly, a company issuing contracts with reserves based on segregated asset accounts shall qualify as a life insurance company for Federal income tax purposes if it satisfies the requirements of section 801(a) (relating to the definition of a life insurance company) and paragraph (b) of § 1.801-3.

(c) *Separate accounting.* (1) For purposes of part I, section 801(g)(3) provides that a life insurance company (as defined in section 801(a) and paragraph (b) of § 1.801-3) which issues contracts with reserves based on segregated asset accounts (as defined in section 801(g)(1)(B) and paragraph (a)(2) of this section) shall separately account for

each and every income, exclusion, deduction, asset, reserve, and other liability item which is properly attributable to such segregated asset accounts. In those cases where such items are not directly accounted for, separate accounting shall be made:

(i) According to the method regularly employed by the company, if such method is reasonable, and

(ii) In all other cases in a manner which, in the opinion of the district director, is reasonable.

A method of separate accounting for such items as are not accounted for directly will be deemed "regularly employed" by a life insurance company if the method was consistently followed in prior taxable years, or if, in the case of a company which has never before issued contracts with reserves based on segregated asset accounts, the company initiates in the first taxable year for which it issues such contracts a reasonable method of separate accounting for such items and consistently follows such method thereafter. Ordinarily, a company regularly employs a method of accounting in accordance with the statute of the State, Territory, or the District of Columbia, in which it operates.

(2) Every life insurance company issuing contracts with reserves based on segregated asset accounts shall keep such permanent records and other data relating to such contracts as is necessary to enable the district director to determine the correctness of the application of the rules prescribed in section 301(g) and this section and to ascertain the accuracy of the computations involved.

(d) *Investment yield.* (1) For purposes of part I, section 801(g)(4)(A) provides that the policy and other contract liability requirements (as determined under section 805), and the life insurance company's share of investment yield (as determined under sections 804(a) or 809(b)), shall be separately computed:

(i) With respect to the items separately accounted for in accordance with section 801(g)(3) and paragraph (c) of this section, and

(ii) Excluding the items taken into account under subdivision (i) of this subparagraph.

Thus, for purposes of determining both taxable investment income and gain or loss from operations, a life insurance company shall separately compute the life insurance company's share of the investment yield on the assets in its segregated asset account without regard to the policy and other contract liability requirements of, and the investment income attributable to, contracts with reserves that are not based on the segregated asset account. Such separate computations shall be made after any allocation required under section 801(g)(4)(B) and subparagraph (2) of this paragraph.

(2)(i) Section 801(g)(4)(B) provides that if the net short-term capital gain (as defined in section 1222(5)) exceeds the net long-term capital loss (as defined in section 1222(8)), determined without regard to any separate computations under section 801(g)(4)(A) and subparagraph (1) of this paragraph, then such excess shall be allocated between section 801(g)(4)(A) (i) and (ii) and subparagraph (1) (i) and (ii) of this paragraph. Such allocation shall be in proportion to the respective contributions to such excess of the items taken into account under each such section and subparagraph. The allocation under this subparagraph shall be made before the separate computations prescribed by section 801(g)(4)(A) and subparagraph (1) of this paragraph.

(ii) The operation of the allocation required under section 801(g)(4)(B) and subdivision (i) of this subparagraph may be illustrated by the following examples:

*Example 1.* For the taxable year 1962, T, a life insurance company which issues regular life insurance and annuity contracts and contracts with reserves based on segregated asset accounts, had (without regard to section 801(g)(4)(A)) realized short-term capital gains of \$10,000 and short-term capital losses of \$10,000 attributable to its general asset accounts and realized short-term capital gains of \$12,000 attributable to its segregated asset accounts. For the taxable year 1962, the excess of the net short-term capital gain (\$10,000+\$12,000-\$10,000, or \$12,000) over the net long-term capital loss (0) was \$12,000. Of the excess of \$12,000, 100 percent was contributed by the segregated asset accounts. Applying the provisions of section 801(g)(4)(B), T would allocate the entire \$12,000 to its segregated asset accounts for such taxable year.

*Example 2.* The facts are the same as in example 1 except that for the taxable year 1962, T had (without regard to section 801(g)(4)(A)) realized short-term capital losses of \$8,000 attributable to its general asset accounts and realized long-term capital gains of \$1,000 and long-term capital losses of \$5,000 attributable to its segregated asset accounts. For the taxable year 1962, the excess of the net short-term capital gain (\$10,000+\$12,000-\$8,000, or \$14,000) over the net long-term capital loss (\$5,000-\$1,000, or \$4,000) was \$10,000. Of the excess of \$10,000, the general asset accounts contributed 20 percent (\$2,000 (\$10,000-\$8,000)+\$10,000) and the segregated asset accounts contributed 80 percent (\$8,000 (\$12,000-\$4,000)+\$10,000). Applying the provisions of section 801(g)(4)(B), T would allocate \$2,000 (\$10,000×20 percent) to its general asset accounts and \$8,000 (\$10,000×80 percent) to its segregated asset accounts for such taxable year.

*Example 3.* W is a life insurance company which issues regular life insurance and annuity contracts and contracts with reserves based on either of two segregated asset accounts, Separate Account C or Separate Account D. For the taxable year 1962, W had (without regard to section 801(g)(4)(A)) realized short-term capital gains of \$16,000 and long-term capital losses of \$15,000 attributable to its general asset accounts, long-term capital gains of \$12,000 and short-term capital losses of \$6,000 attributable to Separate Account C and long-term capital gains of \$7,000 and short-term capital losses of \$5,000 attributable to Separate Account D. For the taxable year 1962, the excess of the net short-term capital gain (\$16,000-\$6,000-\$5,000) over the net long-term capital loss (0) was \$5,000. Of the \$5,000 excess, 20 percent (\$16,000-\$15,000+\$5,000) was contributed by the general asset accounts, leaving 80 percent as the amount contributed by the segregated asset accounts. Applying the provisions of section 801(g)(4)(B) W would allocate \$1,000 (20 percent of \$5,000) to the general asset accounts, leaving \$4,000 (80 percent of \$5,000) to be allocated among the segregated asset accounts, Separate Account C and Separate Account D. W would allocate \$3,000 of the \$4,000 to Separate Account C computed as follows:

$$\$3,000 = \frac{(\$4,000) \times (\$12,000 - \$6,000)}{(\$12,000 - \$6,000) + (\$7,000 - \$5,000)}$$

W would allocate \$1,000 of the \$4,000 to Separate Account D computed as follows:

$$\$1,000 = \frac{(\$4,000) \times (\$7,000 - \$5,000)}{(\$12,000 - \$6,000) + (\$7,000 - \$5,000)}$$

(e) *Policy and other contract liability requirements.* (1) For purposes of part I, section 801(g)(5)(A) provides that with

respect to life insurance reserves based on segregated asset accounts (as defined in section 801(g)(1)(B) and paragraph (a)(2) of this section), the adjusted reserves rate and the current earnings rate for purposes of section 805(b), and the rate of interest assumed by the taxpayer for purposes of sections 805(c) and 809(a)(2), shall be a rate equal to the current earnings rate determined under section 805(b)(2) and paragraph (a)(2) of § 1.805-5 with respect to the items separately accounted for in accordance with section 801(g)(3), reduced by the percentage obtained by dividing:

(i) Any amount retained with respect to all of the reserves based on a segregated asset account by the life insurance company from gross investment income (as defined in section 804(b) and paragraph (a) of § 1.804-3) on segregated assets, to the extent such retained amount exceeds the deductions allowable under section 804(c) which are attributable to such reserves, by

(ii) The means of such reserves.

(2) For purposes of part I, section 801(g)(5)(B) provides that with respect to reserves based on segregated asset accounts other than life insurance reserves, there shall be included as interest paid within the meaning of section 805(e)(1) and paragraph (b)(1) of § 1.805-8, an amount equal to the product of the means of such reserves multiplied by the rate of interest assumed as defined in section 801(g)(5)(A) and subparagraph (1) of this paragraph.

(3) For purposes of this paragraph, any change in the rate of interest assumed by the taxpayer in calculating the reserve on a contract with reserves based on a segregated asset account for any taxable year beginning after December 31, 1961, which is attributable to an increase or decrease in the current earnings rate, shall not be treated as a change of basis in computing reserves for purposes of section 806(b) (relating to certain changes in reserves) or section 810 (d)(1) (relating to adjustment for change in computing reserves).

(4) The provisions of section 801(g) (3) through (5) may be illustrated by the following example. For purposes of this example, it is assumed that all computations have been carried out to a

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sufficient number of decimal places to insure substantial accuracy and to eliminate any significant error in the resulting tax liability.

*Example.* The books of R, a life insurance company, discloses the following facts with respect to items of investment yield, deductions, assets, and reserves for the taxable year 1962:

(a) *Excerpts from Company Financial Statements.*

(1) Investment yield	Company regular account	Separate account A	Separate account B
Interest wholly tax-exempt .....	\$100,000	\$3,000	\$1,000
Interest—other .....	10,000,000	8,000	15,000
Dividends received	200,000	25,000	27,000
Other items of investment yield ....	100,000	2,000	1,000
Gross investment income .....	10,400,000	38,000	44,000
Less deductions (sec. 804(c)) .....	1,000,000	4,000	4,400
Investment yield ....	9,400,000	34,000	39,600
(2) Assets and reserves:			
(i) Assets:			
Jan. 1, 1962 ...	190,000,000	.....	.....
Dec. 31, 1962	210,000,000	1,600,000	1,800,000
Mean .....	200,000,000	800,000	900,000
(ii) Life insurance reserves:			
Jan. 1, 1962 ...	152,000,000	.....	.....
Dec. 31, 1962	168,000,000	1,600,000	1,640,000
Mean .....	160,000,000	800,000	820,000
(iii) Reserves based on segregated asset accounts other than life insurance reserves:			
Jan. 1, 1962 ...	.....	.....	.....
Dec. 31, 1962	.....	.....	120,000
Mean .....	.....	.....	60,000

(b) *Additional facts.* In addition to the facts assumed in (a) above, assume the following: The company retained with respect to reserves based upon segregated asset accounts a total of \$4,720 from gross investment income on Separate Account A and \$5,720 from gross investment income on Separate Account B. With respect to the Company Regular Account computed without regard to the items in either of the separate accounts, the policy and other contract liability requirement is \$6,580,000 and the required interest is \$5,640,000. There are no items of interest paid with respect to the separate accounts other than those computed under section 801(g)(5)(B). Based on these facts, the current earnings rate (sec. 805(b)); adjusted reserves rate (sec. 805 (b)); and rate of inter-

est assumed (secs. 805(c) and 809(a)(2)); and the policy and other contract liability requirements are determined for each of the Separate Accounts A and B (and the policy and other contract liability requirements for the Company Regular Account) as set forth in items (c) through (1) below.

(c) *Separate Account A.* The current earnings rate determined under section 805 (b)(2) with respect to the items separately accounted for under Separate Account A, prior to the reduction provided for under section 801(g)(5)(A), is 4.25 percent (the investment yield, \$34,000, divided by the mean of the assets, \$800,000). The company retained with respect to such reserves from gross investment income on Separate Account A a total of \$4,720. The company had deductions allowable under section 804(c) with respect to such account of \$4,000. Accordingly, for purposes of section 801(g)(5)(A)(i), the amount retained by the company was \$720 (the total amount retained of \$4,720 less the deductions allowable under section 804(c) of \$4,000). The reduction percentage for purposes of section 801(g)(5)(A) is 0.09 percent (the amount retained of \$720 divided by the mean of the life insurance reserves of \$800,000). Therefore, the adjusted reserves rate and the current earnings rate for purposes of section 805(b), and the rate of interest assumed for purposes of sections 805(c) and 809(a)(2) is equal to 4.16 percent (the current earnings rate of 4.25 percent less the reduction percentage of 0.09 percent).

The policy and other contract liability requirements with respect to Separate Account A is determined as follows: For purposes of section 805(a) (1) and (2), the amount is \$33,280 (the mean of the life insurance reserves, \$800,000, multiplied by the current earnings rate, as determined under section 801(g)(5)(A), 4.16 percent). Thus, the policy and other contract liability requirement for Separate Account A is \$33,280.

(d) *Separate Account B.* The current earnings rate determined under section 805 (b)(2) with respect to the items separately accounted for under Separate Account B, prior to the reduction provided for under section 801(g)(5)(A), is 4.40 percent (the investment yield, \$39,600 divided by the mean of the assets, \$900,000). The company retained with respect to such reserves from gross investment income on Separate Account B a total of \$5,720. The company had deductions allowable under section 804(c) with respect to such account of \$4,400. Accordingly, for purposes of section 801(g)(5)(A)(i) the amount retained by the company was \$1,320 (the total amount retained of \$5,720 less the deductions allowable under section 804(c) of \$4,400). The reduction percentage for purposes of section 801(g)(5)(A) is 0.15 percent (the amount retained of \$1,320 divided by the mean of the reserves based on Separate Account B of \$880,000 (\$820,000 plus \$60,000)). Therefore, the

adjusted reserves rate and the current earnings rate for purposes of section 805(b), and the rate of interest assumed for purposes of section 805(c) and 809(a)(2) is equal to 4.25 percent (the current earnings rate of 4.40 percent less the reduction percentage of 0.15 percent).

With respect to reserves based on segregated asset accounts other than life insurance reserves, Separate Account B had such reserves at December 31, 1962, of \$120,000. The mean of such reserves was \$60,000. The rate of interest assumed with respect to such reserves is 4.25 percent, as computed above. Accordingly, there shall be included as interest paid within the meaning of section 805(e)(1) the amount of \$2,550 (the mean of such reserves, \$60,000 multiplied by the rate of interest assumed of 4.25 percent).

The policy and other contract liability requirements with respect to Separate Account B is determined as follows:

(1) For purposes of section 805(a)(1) and (2), the amount is \$34,850 (the mean of the life insurance reserves, \$820,000, multiplied by the current earnings rate, as determined under section 801(g)(5)(A), 4.25 percent).

(2) For purposes of section 805(a)(3), the amount is \$2,550 (the mean of the reserves based on Separate Account B other than life insurance reserves, \$60,000, multiplied by the rate of interest assumed, as determined under section 801(g)(5)(A), 4.25 percent). It has been assumed that there was no other interest paid on Separate Account B within the meaning of section 805(e). If there was other interest paid with respect to Separate Account B that met the requirements of section 805(e), however, then such interest

would be included under section 805(a)(3). Thus, the policy and other contract liability requirement for Separate Account B is \$37,400 (\$34,850+\$2,550).

(e) *Company Regular Account.* The policy and other contract liability requirements with respect to the Company Regular Account is \$6,580,000 (this amount is determined by the company in the manner provided by section 805 (and the regulations thereunder) without regard to either Separate Account A or Separate Account B).

(f) *Policyholders' share and company's share of investment yield—section 804.* The policyholders' and company's share of investment yield and taxable investment income are computed as follows:

(1) *Company Regular Account*

Policyholders' share of investment yield.	70% (\$6,580,000÷\$9,400,000).
Company's share of investment yield (100% less 70%).	30%.

(2) *Separate Account A*

Policyholders' share of investment yield.	97.8824% (\$33,280 ÷\$34,000).
Company's share of investment yield (100% less 97.8824%).	2.1176%.

(3) *Separate Account B*

Policyholders' share of investment yield.	94.444% (\$37,400 ÷\$39,600).
Company's share of investment yield (100% less 94.444%).	5.556%.

(g) *The company's share of investment yield under section 804 is determined as follows:*

Investment yield (from item (a)(1))	Company regular account (30 percent times each amount in item (a)(1))	Separate account A (2.1176 percent times each amount in item (a)(1))	Separate account B (5.556 percent times each amount in item (a)(1))
Interest wholly tax-exempt .....	\$30,000	\$63.53	\$55.56
Interest—other .....	3,000,000	169.41	833.40
Dividends received .....	60,000	529.40	1,500.12
Other items of gross investment income. ....	30,000	42.35	55.56
	3,120,000	804.69	2,444.64
Less deductions .....	300,000	84.70	244.46
Investment yield .....	2,820,000	719.99	2,200.18

(h) *Taxable investment income.* The company's taxable investment income (without regard to any excess of net long-term capital gain over net short-term capital loss) is determined as follows:

Life insurance company's share of investment yield (\$2,820,000+\$719.99÷2,200.18) .....	\$2,822,920.17
Less:	
Company's share of interest wholly tax-exempt (\$30,000÷\$63.53+\$55.56)=\$30,119.09	
85 percent of company's share of dividends received (but not to exceed 85% of taxable investment income computed without regard to this deduction) (85%×\$62,029.52) (\$60,000+\$529.40+\$1,500.12)=\$52,725.09	
Small business deduction (10% of investment yield, \$9,473,600, not to exceed \$25,000) =\$25,000.00	107,844.18
Taxable investment income .....	2,715,075.99

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(i) *Required interest—section 809(a)(2)*— (1) *Separate Account A.* The rate of interest assumed by the company, with respect to Separate Account A is 4.16 percent (see (c) above). The required interest for purposes of section 809(a)(2) is determined as follows:

Life insurance reserves: 4.16% (rate assumed) times \$800,000 (mean of life insurance reserves) ..... \$33,280.00

(2) *Separate Account B.* The rate of interest assumed by the company with respect to Separate Account B is 4.25 percent (see (d) above). The required interest for purposes of section 809(a)(2) is determined as follows:

(i) Life insurance reserves: 4.25% (rate assumed) times \$820,000 (mean of life insurance reserves) ..... \$34,850.00

(ii) Other section 810(c) reserves: 4.25% (rate assumed) times \$60,000 (mean of reserves other than life insurance reserves) ..... \$2,550.00  
\$37,400.00

(3) *Company Regular Account.* The required interest with respect to the Company Regular Account is \$5,640,000 (this amount is assumed for purposes of this example, but it would be determined by the company in the manner provided by section 809 without regard to either Separate Account A or Separate Account B).

(j) *Policyholders' share and company's share of investment yield—section 809.* The policyholders' share and the company's share of investment yield for purposes of section 809 is determined as follows:

(1) *Company Regular Account:*  
Policyholders' share of investment yield ..... 60% (\$5,640,000÷\$9,400,000).  
Company's share of investment yield (100 percent—60%), ..... 40%.

(2) *Separate Account A:*  
Policyholders' share of investment yield ..... 97.8824% (\$33,280÷\$34,000).  
Company's share of investment yield (100%—97.8824 percent), ..... 2.1176%.

(3) *Separate Account B:*  
Policyholders' share of investment yield ..... 94.444% (\$37,400÷\$39,600).  
Company's share of investment yield (100%—94.444%), ..... 5.556%.

(k) *The company's share of investment yield under section 809 is determined as follows:*

Investment yield (from item (a)(1))	Company regular account (40 percent times each amount in item (a)(1))	Separate account A (2.1176 percent times each amount in item (a)(1))	Separate account B (5.556 percent times each amount in item (a)(1))
Interest wholly tax-exempt .....	\$40,000	\$63.53	\$55.56
Interest—other .....	4,000,000	169.41	833.40
Dividends received .....	80,000	529.40	1,500.12
Other items of gross investment income .....	40,000	42.35	55.56
Less deductions .....	4,160,000	804.69	2,444.64
	400,000	84.70	244.46
Investment yield .....	3,760,000	719.99	2,200.18

(1) *Deductions under section 809(d)(8).* For purposes of section 809(d)(8), the life insurance company's share of each of such items is determined as follows:

(1) Wholly tax-exempt interest (\$40,000+\$63.53+\$55.56) ..... \$40,119.09  
(2) Dividends received 85%× \$82,029.52 (\$80,000+\$529.40+\$1,500.12) (it is assumed for purposes of this example that this amount does not exceed 85% of the gain from operations as computed under sec. 809(d)(8)(B)) ..... 69,725.09

(f) *Increases and decreases in reserves.*  
(1) Section 801(g)(6) provides that for purposes of section 810 (a) and (b) (relating to adjustments for increases or decreases in certain reserves), the sum

of the items described in section 810(c) and paragraph (b) of §1.810-2 taken into account as of the close of the taxable year shall be adjusted:

(i) By subtracting therefrom the sum of any amounts added from time to time (for the taxable year) to the reserves separately accounted for in accordance with section 801(g)(3) and paragraph (c) of this section by reason of realized or unrealized appreciation in value of the assets held in relation thereto, and

(ii) By adding thereto the sum of any amounts subtracted from time to time

(for the taxable year) from such reserves by reason of realized or unrealized depreciation in the value of such assets.

(2) The provisions of subparagraph (1) of this paragraph may be illustrated by the following example:

*Example.* Company M, a life insurance company issuing only contracts with reserves based on segregated asset accounts as defined in section 801(g)(1)(B) and paragraph (a)(2) of this section (other than contracts described in section 805(d)(1) (A), (B), (C), or (D)), increased its life insurance reserves held with respect to such contracts during the taxable year 1962 by \$275,000. Of the total increase in the reserves, \$100,000 was attributable to premium receipts, \$50,000 to dividends and interest, \$100,000 to unrealized appreciation in the value of the assets held in relation to such reserves, and \$25,000 to realized capital gains on the sale of such assets. As of the close of the taxable year 1962, the reserves held by company M with respect to all such contracts amounted to \$1,275,000. However, under section 801(g)(6) and this subparagraph, this amount must be reduced by the \$100,000 unrealized asset value appreciation and the \$25,000 of realized capital gains. Accordingly, for purposes of section 810(a) and (b), the amount of these reserves which is to be taken into account as of the close of the taxable year 1962 under section 810(c) is \$1,150,000 (\$1,275,000 less \$125,000). However, for purposes of section 810 (a) and (b), the amount of these reserves which is to be taken into account as of the beginning of the taxable year 1963 under section 810(c) is \$1,275,000 (the amount as of the close of the taxable year 1962 before reduction of \$125,000 for unrealized appreciation and realized capital gains).

(3)(i) Under section 801(g)(6), the deduction allowable for items described in section 809(d) (1) and (7) (relating to death benefits and assumption reinsurance, respectively) with respect to segregated asset accounts shall be reduced to the extent that the amount of such items is increased for the taxable year by appreciation (or shall be increased to the extent that the amount of such items is decreased for the taxable year by depreciation) not reflected in adjustments required to be made under subparagraph (1) of this paragraph.

(ii) The provisions of this subparagraph may be illustrated by the following example:

*Example.* On June 30, 1962, X, a life insurance company, reinsured a portion of its insurance contracts with reserves based on

segregated asset accounts with Y, a life insurance company, under an agreement whereby Y agreed to assume and become solely liable under the contracts reinsured. The reserves on the contracts reinsured by X were \$90,000, of which \$10,000 was attributable to unrealized appreciation in the value of the assets held in relation to such reserves. However, no amounts had been added to the reserves by reason of the unrealized appreciation of \$10,000 and consequently, the \$10,000 was not reflected in adjustments to reserves under section 809(g)(6) or subparagraph (1) of this paragraph. Under the reinsurance agreement, X made a payment of \$90,000 in cash to Y for assuming such contracts. Applying the provisions of section 809(d)(7), and assuming no other such reinsurance transactions by X during the taxable year, X would have an allowable deduction of \$90,000 as a result of this payment on June 30, 1962. However, applying the provisions of section 801(g)(6) and this subparagraph, the actual deduction allowed would be \$80,000 (\$90,000 less \$10,000). See section 806 (a) and § 1.806-3 for the adjustments in reserves and assets to be made by X and Y as a result of this transaction. For the treatment by Y of this \$90,000 payment, see section 809(c)(1) and paragraph (a)(1)(i) of § 1.809-4.

(g) *Basis of assets held for certain pension plan contracts.* Section 801(g)(7) provides that in the case of contracts described in section 805(d)(1) (A), (B), (C), (D), or (E) (relating to the definition of pension plan reserves), the basis of each asset in a segregated asset account shall (in addition to all other adjustments to basis) be (i) increased by the amount of any appreciation in value, and (ii) decreased by the amount of any depreciation in value; but only to the extent that such appreciation and depreciation are reflected in the increases and decreases in reserves, or other items described in section 801(g)(6), with respect to such contracts. Thus, there shall be no capital gains tax payable by a life insurance company on appreciation realized on assets in a segregated asset account to the extent such appreciation has been reflected in reserves, or other items described in section 801(g)(6), for contracts described in section 805(d)(1) (A), (B), (C), (D), or (E) based on segregated asset accounts.

(h) *Additional separate computation—*  
(1) *Assets and total insurance liabilities.* A life insurance company which issues contracts with reserves based on segregated asset accounts (as defined in



section 801(g)(1)(B) and paragraph (a)(2) of this section) shall separately compute and report with its return the assets and total insurance liabilities which are properly attributable to all of such segregated asset accounts. Each foreign corporation carrying on a life insurance business which issues such contracts shall separately compute and report with its return assets held in the United States and total insurance liabilities on United States business which are properly attributable to all of such segregated asset accounts.

(2) *Foreign life insurance companies.* For adjustment under section 819 in the case of a foreign life insurance company which issues contracts based on segregated asset accounts under section 801(g), see § 1.819-2(b)(4).

[T.D. 6886, 31 FR 8681, June 23, 1966, as amended by T.D. 6970, 33 FR 12044, Aug. 24, 1968; T.D. 7501, 42 FR 42341, Aug. 23, 1977]

#### § 1.802(b)-1 Tax on life insurance companies.

(a) For taxable years beginning after December 31, 1953, but before January 1, 1955, and ending after August 16, 1954, section 802(b) imposes a tax on the 1954 life insurance company taxable income of all life insurance companies (including a foreign life insurance company carrying on a life insurance business within the United States if with respect to its United States business it would qualify as a life insurance company under section 801). The tax so imposed is equal to 3 3/4 percent of the amount of such income not in excess of \$200,000, plus 6 1/2 percent of the amount of such income in excess of \$200,000. For the definition of the term "1954 life insurance company taxable income", see § 1.805-1.

(b) The taxable income of life insurance companies differs from the taxable income of other corporations. See section 803. Life insurance companies are entitled, in computing life insurance company taxable income, to the special deductions provided in part VIII (section 241 and following), except section 248, subchapter B, chapter 1 of the Code. The gross income, the deduction under section 803 (g)(1) for wholly tax-exempt interest, and the deduction under section 242 for partially tax-ex-

empt interest, are decreased by the appropriate amortization of premium and increased by the appropriate accrual of discount attributable to the taxable year on bonds, notes, debentures, or other evidences of indebtedness held by a life insurance company. See section 803 (i) and § 1.803-6. Such companies are not subject to the provisions of subchapter P (section 1201 and following), chapter 1 of the Code, relating to capital gains and losses, nor to the provisions of section 171 (amortizable bond premium).

(c) All provisions of the Code and of the regulations in this part not inconsistent with the specific provision of sections 801 to 807, inclusive, are applicable to the assessment and collection of the tax imposed by section 802, and life insurance companies are subject to the same penalties as are provided in the case of returns and payment of income tax by other corporations. The return shall be on Form 1120L.

(d) Foreign life insurance companies not carrying on an insurance business within the United States are not taxable under section 802, but are taxable as other foreign corporations. See section 881.

#### § 1.802-2 Taxable years affected.

Section 1.802(b)-1 is applicable only to taxable years beginning after December 31, 1953, and before January 1, 1955, and all references to sections of part I, subchapter L, chapter 1 of the Code are to the Internal Revenue Code of 1954, before amendments. Sections 1.802-3 through 1.802-5 (other than paragraph (f)(2) of § 1.802-3), except as otherwise provided therein, are applicable only to taxable years beginning after December 31, 1957, and all references to sections of part I, subchapter L, chapter 1 of the Code are to the Internal Revenue Code of 1954, as amended by the Life Insurance Company Income Tax Act of 1959 (73 Stat. 112) and section 235(c)(1) of the Revenue Act of 1964 (78 Stat. 126). Paragraph (f)(2) of § 1.802-3 is applicable only to taxable years beginning after December 31, 1961, and all reference to sections of part I, subchapter L, chapter 1 of the Code are to the Internal Revenue Code of 1954, as amended by the Life Insurance Company Income Tax Act of 1959 (73 Stat.